Social Media Campaign Sways Proxy Vote at Prospect Capital

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When two cultures collide, you can never predict the results. William the Conquerors French-speaking Normans defeated the Anglo-Saxons in 1066 and changed England forever. The AOL hordes stormed the gates at Time Warner in 2000 and nearly destroyed the old media giant by the time they were done, a merger that left both sides punch-drunk and staggering.

Fast forward to 2014, and we have another culture clash – albeit on a much smaller scale: The decision by Russell and a few other large institutions to pull their indexes out of business development companies (BDCs) – closed-end fund structures that focus on lending and equity ownership to small companies and distributing at least 90 percent of income to shareholders. Those

institutions pulling out of BDCs had to sell their shares somewhere – and individual retail investors, lured by double digit yields, descended on them en masse.

Now, that presented Prospect Capital with a problem. For years, the company had been issuing additional shares – even at a discount – in order to raise money to make investments that had on the whole been profitable for new and old shareholders alike.

Furthermore, the mere fact that PSEC's management team had had the ability to issue shares also helped the company by reducing its cost of capital. Ratings agencies looking at BDCs believe that a BDC that can raise equity funding at will, in a pinch, is less likely to default than a BDC that doesn't have that flexibility – all other things being equal. And so PSEC's shareholders benefited from the higher credit rating and lower interest rate on its debt compared to what it likely would have had to have paid had the company's operating documents forbade the use of issuing additional shares to raise emergency capital.

For years, the institutional shareholder base was generally fine with this. So long as the company didn't abuse the privilege, the institutional investors were happy to pay the price of occasional share dilution as small compared to the cost of a hit on the company's credit rating, and also to the opportunity cost that would have ensued if the company had to pass on lucrative investment opportunities because it did not have the capital on hand to make the deal.

And so Prospect's management didn't have much trouble getting shareholder approval each year to do so. Meanwhile, heading into the fall, with the key proxy vote looming on December 5th, the issue was in doubt. Prospect's management team wasn't getting its message out. In previous years, similar proposals had passed easily with 70 to 75 percent of the voting shares.

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This year, things were different.

Now that much of the institutional ownership was out, and yield-hungry individual investors were in, the company's management found that getting permission to dilute current investors' ownership by issuing new shares at a discount to NAV was a tougher sell with this crowd. These investors took to bulletin boards railing against the dilutive effect of new share issuances.

"Prospect Capital has proven it can't be trusted with the temptation of growing its balance sheet with below-NAV stock sales. Shareholders shouldn't be enablers for this growth addict," wrote Jordan Wathen on The Motley Fool.

Prospect's management team, however, led by president Grier Eliasek, believed strongly that they needed the flexibility to issue shares – even on a dilutive basis – in order to maintain their dividend record and find opportunities for their shareholders.

Meanwhile, heading into the fall, with the key proxy vote looming on December 5th, the issue was in doubt. Prospect's management team wasn't getting its message out. In previous years, similar proposals had passed easily with 70 to 75 percent of the voting shares. But this year, with BDCs somewhat out of favor, and a new mix of retail investors new to the BDC business, the early tallies were coming in far short of the mark.

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communicating didn't seem to be reaching retail shareholders. And even if a staffer were able to reach a shareholder, via a phone call, there were thousands of shareholders. They could never call them all to persuade them to vote "yes" on their proposal, or to switch their votes if they had already voted.

So they came to Warren Antler, a shareholder relations veteran and head of the Closed End Fund Program at AST Fund Solutions, with the problem.

Antler's solution: Put Eliasek on camera. Have him make a personal, visual appeal to shareholders. Look them right in the eye and explain to them why the vote was so important and why they needed to vote "yes" on Proposal 2.

Here was the logic, according to Antler: Let's give the viewer a chance to see something they normally don't get a chance to view at the retail investor level: A formal investor relations presentation. "The primary benefit of the video is to allow retail shareholders to get a glimpse of a typical conversation that would take place during an IR presentation," said Antler via an email. "It is an innovative approach outside of the normal tools used during the proxy solicitation process, yet it is one that we believe is an effective way of explaining a complex issue to investors."

Prospect bought the idea, and worked out a brief, punchy two-minute script detailing the argument: If the proposal failed, Prospect Capital would suffer a credit rating hit, possibly falling below investment grade. The cost of capital would increase, and the company would not be able to take advantage of some lucrative investment opportunities that would benefit new and existing shareholders alike.

For the video production and distribution phase, they turned to Pristine Advisers, a long-time investor relations firm specializing in the Closed-End Fund world and with

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strong experience in social media and video production. Pristine Advisers made the video, Prospect Capital got it up on their own website, while Pristine Advisers worked on posting it on YouTube, while at the same time seeding key social media feeds with the link.

"By utilizing all of our social media channels we were able to watch the YouTube hits increase tremendously," explains Pristine Advisers' CEO, Patricia Baronowski. "In my 25 years of IR/PR and its ever-evolving methods of outreach, we have come to realize over the past few years that social media (YouTube, Twitter, LinkedIn, etc.) all have a much wider reach than standard marketing alone."

The result was phenomenal. The

video got over 7,000 hits in less than a month – and led to investors calling in to change their proxies to "yes" by the thousands.

According to AST Fund Solutions, after the video posted,

- 139 shareholders representing 649,589 shares called the toll-free number and actually switched their votes from No on Proposal 2 to Yes.
- 5,369 shareholders who were sent letters viewed the video and voted 21,294,994 shares For Prop 2.

While it's impossible to tabulate what motivated each voter, it appears that the 82 percent of people who called to change their votes after seeing the video wound up voting "yes."

Ironically, just a few days after arguing that it needed the proposal to go through to cover its dividend, Prospect Capital announced it was slashing its dividend anyway, from just over 11 cents down to 8.333 cents per share, for the time being. The company also announced it was suspending its ATM share issuance program until further notice, as well, in two signs the company was pulling in its horns and dialing back expectations.

"We have elected in the past year to take on less risk and focus on higher earnings quality by increasing our percentage of first lien loans and accepting lower interest rates in this yield compressed environment," said John F. Barry III, Chairman and Chief Executive Officer of Prospect, continuing, "While we have more than covered our prior dividends out of taxable earnings, we are reducing the next three declared dividends from past levels because we believe we should pay a dividend that is no more than our minimum expected net investment income, based on our expectations over the next twelve months."

Would the vote have gone differently if PSEC had disclosed the sour news about the dividend beforehand? Who knows? What does seem to have occurred, though, is that a sea change in BDC investor relations practices may be underway, as BDCs adjust to having to make their case to a wider range of smaller investors, deeply suspicious of anything smacking of dilution.

BDCs, it seems, will soon need to step up their communications game. No longer can they rely on making their case to a cozy and narrow group of familiar institutions. BDCs will now have to wade into the Court of Public Opinion to get their preferred proxies passed and counter some of an increasingly activist and dissenting sentiment.

"Despite the naysayers in the media, the people have spoken and the vote was passed," said Pristine Adviser's Patricia Baronowski. "The program was a success, the video had traction and we could see by our analytics that tweets were getting retweeted, posts were getting shared and people "paid attention" it was the first time this had been done and we were very excited to be a part of it," said Patricia Baronowski, CEO of Pristine Advisers and the producer of the Prospect video.